LEXXOR ENERGY INC.

annual report

ANNUAL MEETING OF SHAREHOLDERS

Shareholders are encouraged to attend Lexxor's Annual Meeting of Shareholders which will be held on Thursday, June 5, 1997 at 3:45 p.m. in the main boardroom of Code Hunter Wittmann, 1400, 700 Second Street S.W., Scotia Centre, Calgary, Alberta. Those unable to attend are requested to complete and return the Proxy Form.

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ABBREVIATIONS & TERMS

ARTC	Alberta Royalty Tax Credit
Bbls	barrels
MBbls	thousand barrels
BOPD	barrels of oil per day
Mcf	thousand cubic feet
Mmcf	million cubic feet
Bcf	billion cubic feet
BOE	barrel of oil equivalent
/d	per day
MBOE	thousand barrels of oil equivalent
Ngl	natural gas liquids
	Natural gas is equated to oil on the basis of: 10 Mcf - 1 barrel of oil equivalent

CORPORATE PROFILE

LEXXOR ENERGY INC. IS A CALGARY BASED JUNIOR EXPLORATION COMPANY WITH EXPANDING OIL AND GAS OPERATIONS IN WESTERN CANADA.

LEXXOR COMMENCED OPERATIONS IN LATE-1995 FOLLOWING THE CLOSING OF AN INITIAL PUBLIC OFFERING. THE COMPANY'S INITIAL DRILLING PROGRAM IN EARLY 1996 LED TO THE DISCOVERY OF NATURAL GAS AND LIQUIDS RESERVES IN NORTHEASTERN BRITISH COLUMBIA. MID-1996 SAW LEXXOR UNDERTAKE AN ACTIVE AND SUCCESSFUL EXPLORATION PROGRAM IN THE SOUTHERN PLAINS PROJECT AREA WHILE DIVESTING OF INTERESTS IN CERTAIN NORTHERN GAS PROJECTS, RETAINING A POSITION IN ONLY THOSE NORTHERN RESERVES HAVING NEAR TERM PRODUCTION POTENTIAL.

FOLLOWING A LATE 1996 PUBLIC OFFERING AND SUBSEQUENT PRIVATE PLACEMENT, LEXXOR IS DEBT-FREE, HAS $3 MILLION CASH-ON-HAND AND PLANS AN ACTIVE 1997, ENTAILING A $7 MILLION, 30 WELL PROGRAM, INCLUDING EXPLORATORY DRILLING, DEVELOPMENT OF EARLIER DISCOVERIES AND TIE-IN OF SIX GAS WELLS INTO A NEW GAS PLANT IN NORTHEAST BRITISH COLUMBIA.

THE COMPANY'S SHARES AND WARRANTS TRADE ON THE ALBERTA STOCK EXCHANGE UNDER THE TRADING SYMBOLS SHOWN BELOW:

HIGHLIGHTS

December 31		1996		1995
FINANCIAL				
Working Capital	$	2,349,990	$	3,989,521
Total Assets	$	8,036,389	$	4,833,572
Bank Debt	$	—	$	—
Capital Expenditures	$	8,291,399	$	494,611
Shareholders' Equity	$	6,861,000	$	4,309,132
Share Capital				
Class A shares outstanding		7,003,600		4,483,600
Class B shares				
Issued for cash on initial public offering		—		871,556
Reserved for issue March 1, 1996 related to initial public offering		—		546,900
		1,418,456		1,418,456
Class A Share Purchase Warrants outstanding		1,541,800		1,541,800
OPERATING				
Land Holdings				
Gross Acres		53,992		1,280
Net Acres		13,600		51
Reserves (proved and risked probable)				
Natural Gas (mmcf)		5,206		109
Natural Gas Liquids (MBbls)		78		2.5
Crude Oil (thousands of barrels)		194		—
Present Value of Reserves ($, thousands discounted at 15% before tax)		3,546		58
Wells drilled				
Gross		31		2.0
Net		7.6		0.1
Production				
BOE/d		52		—

We are pleased to provide Lexxor Shareholders with this report on the progress of our Company following an active and productive twelve months.

As the result of financial and operating strategies implemented in 1996, the Company is in an excellent position to commence a new phase of growth in a highly competitive energy industry environment. A debt-free Lexxor has the proceeds from a late 1996 public offering in hand. With a private placement of equity subsequently completed and the recent sale of a shut-in gas property, the Company is in a strong financial position to pursue our growing prospect inventory as new oil and gas production is brought on stream in early 1997.

1996 IN REVIEW

The first full year of Lexxor's operation was marked by some early concerns and several positive developments. Revenue delays, stemming from the nature of our first quarter, 1996 program, combined with longer than expected lead times in bringing Southern Area prospects to the drilling phase slowed the evolution of expected financial and operating results. A strong fourth quarter drilling program has provided development drilling opportunities adjacent to new discoveries and has established the threshold gas reserves required to proceed with construction of a new gas plant in northern British Columbia. Highlights of Lexxor's first year include:

Drilling Activity: To December 31, 1996 Lexxor participated in the drilling of 31 wells (at an average interest of 25%) resulting in 21 potential gas wells, 4 potential oil wells and 6 dry holes for a success ratio of 76%.

Joint Venture Program: Of 31 wells drilled in 1996, 22 were operated by Blue Range Resource Corporation under the terms of a formal Participation Agreement. Under the Reciprocal Agreement, Blue Range is participating in Lexxor generated prospects in the heavy oil corridor of western Saskatchewan and in light oil plays in east central Alberta.

Staffing: Lexxor welcomed Wayne E. Merkel as Exploration Manager and Patricia J. Allen as Office Manager in early 1996, bringing our staff to its current level of four. In addition, consultants have been retained in the areas of Engineering, Land, Accounting and Geophysics.

Market Awareness: Lexxor presented its corporate story at the Canadian Association of Petroleum Producers Symposium in June (Calgary), at the Canadian Oil Patch Investor Conference in September (Toronto) and the Energy Communications Oil and Gas Forum in early 1997 (Calgary). When combined with the numerous presentations to corporate finance and retail representatives during the course of the year, it is felt that the investment community is becoming increasingly aware of the Lexxor opportunity.

Access to Capital: During the course of 1996 Lexxor maintained its debt-free status through the sale of non-core properties for proceeds of $1,250,000, through a fully subscribed public offering of flow-through shares for gross proceeds of $3,000,000 and through a subsequent $500,000 private placement. A $750,000 bank line of credit was also negotiated. Subsequent to year-end the Company closed the sale of working interests in a shut-in gas property at Martin, British Columbia for net proceeds of $525,000.

Fourth Quarter Drilling: The Company enjoyed a very successful fourth quarter which included the drilling of three oil wells and six gas wells (five planned for early 1997 production). The drilling of four new gas wells at Conroy, British Columbia has provided the reserve threshold required to proceed with gas plant construction, while oil successes have added new volumes to our production base and provide follow-up drilling opportunities.

Production: Lexxor has seen its production increase from a modest 60 BOED in late 1996 to 160 BOED in early 1997, with expectations of exceeding 300 BOED by early April, 1997.

Reserves: Lexxor's strong fourth quarter resulted in an approximate 50% increase in oil and gas reserves to 920,000 barrels of oil equivalent (proved plus probable) of which 660,000 BOE are proved.

Results of 1996 activity will be reflected in our 1997 program as follows:

A continuing shift in our geological and geographical focus away from higher cost, remote northern areas toward multizone medium depth prospects in south central Alberta and western Saskatchewan.

A balancing of our commodity mix in reserves and production, targeting an approximate 50/50 split between oil and natural gas.

A gradual move toward operational control as Lexxor generated prospects are delineated, acquired and reach the drilling stage.

As highlighted earlier, our 1996 program has established a solid base for future growth. We recognize, however that there is a need for improvement in certain important facets of our business. Areas which we have identified and began addressing in 1996 include:

Production Revenue:

Lexxor's early participation in the Northern Area joint venture resulted in the discovery of natural gas reserves, but due to the nature of the terrain and related seasonal access restrictions, production and revenue lead times can be lengthy. Management identified those properties containing reserves not expected to produce for some time and sold those shut-in reserves for proceeds of $1.78 million ($1.25 million in late 1996, $0.53 million in early 1997). Cash generated from the divestitures has been reallocated to Southern Area prospects and resulted in late 1996 oil discoveries which are now on production and generating cash flow.

Finding Costs

Lexxor's finding and onstream costs for oil and gas reserves were unacceptably high in 1996. High drilling and access costs in the Northern Area led the Company to act decisively on Northern divestitures and implement a move to Southern Plains prospect areas where year round access, shallower drilling, multizone potential and existing production infrastructure provide a more appropriate operational environment for a junior exploration company like Lexxor. Finding and onstream costs for reserves in the Southern Plains project have been markedly lower than those for Northern Area projects.

Operating Costs/Netbacks

During 1996 Lexxor had no working interests in gas facilities or oil batteries. Fees to third party processors and operators of oil treating facilities and water disposal wells increased operating costs and therefore reduced netbacks on

our modest 1996 production volumes. In 1997 Lexxor is taking an ownership position in a new gas plant at Conroy, British Columbia (our most significant gas property) and plans to establish a Company owned battery and water disposal facility at our heavy oil project in western Saskatchewan.

Operational Control

Lexxor operated just one of 31 wells drilled in 1996. The coming year will see us moving toward operating more of our projects which will allow us to exercise control over the magnitude and timing of project expenditures while retaining control of the revenue stream.

1997 OUTLOOK

Any forward looking 1996 Annual Report for a junior energy exploration company would not be complete without addressing the increasingly high profile matter of drilling rig availability. Like most smaller companies Lexxor's activity levels during the first quarter have been tempered, but by no means curtailed, by equipment shortages. Despite this industry wide problem the Company participated in ten wells in late 1996 and six wells in the first quarter of 1997, including a three well, Lexxor-operated program in Saskatchewan in March. We project that shallow depth rigs will become increasingly available on a one or two well "window" basis after spring breakup as equipment migrates south from northern gas areas. Lexxor has aligned itself with a strong engineering consulting firm, and through this association is actively pursuing a strategy to improve access to drilling rigs and related services. We are confident that our drilling plans will be achieved by year end with only modest, intermittent delays in certain prospect areas.

Our 1997 Annual Plan contemplates expenditures in excess of $7 million and the drilling of up to 30 wells, with a focus on an approximate balance of oil and gas prospects, primarily in south central Alberta and western Saskatchewan. Lexxor will continue to finance its exploration and development program using a combination of cash flow, equity and debt. A regular re-assessment of our internal assumptions will maintain our flexibility to adapt to a changing environment. With the ever present volatility in energy commodity prices and in the equity market place, we prefer to focus on those factors within our realm of control. Operating efficiency, the generation of and participation in viable projects and the implementation of a proactive business plan are all elements over which we can exhibit control. Lexxor's plan for 1997 will result in a new phase of growth as we emerge from our first full year of operation.

I would like to express my appreciation to Lexxor's shareholders for their early support of a true "start-up" venture. Our small group of focused and energetic employees, consultants and directors have been instrumental in positioning the Company for a new phase of growth. Their dedication is acknowledged as we move into an exciting second year of building a profitable junior energy company.

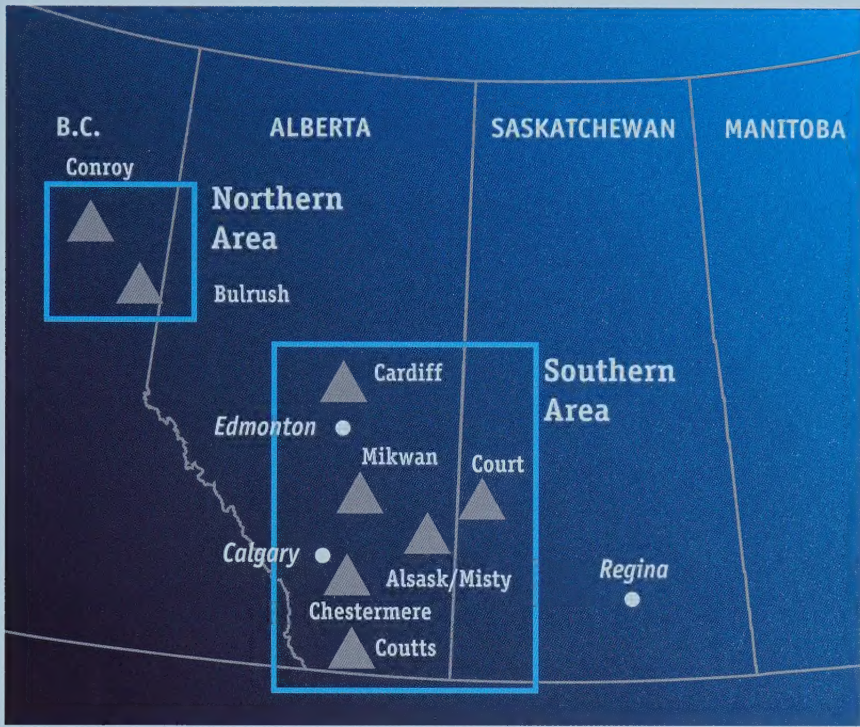
Ronald R. Talbot
President and Chief Executive Officer

March 26, 1997

CORE PROJECT AREAS

DURING LEXXOR'S FIRST FULL YEAR OF OPERATION THE COMPANY PARTICIPATED IN A FIRST QUARTER DRILLING PROGRAM IN NORTH EASTERN BRITISH COLUMBIA UNDER THE TERMS OF A FORMAL PARTICIPATION AGREEMENT. WHILE DRILLING RESULTS WERE POSITIVE (14 WELLS CASED FOR GAS POTENTIAL OF 18 WELLS DRILLED), TIE-IN DELAYS DUE TO REMOTE ACCESS RESULTED IN CORRESPONDING DELAYS IN THE GENERATION OF PRODUCTION REVENUE, WITH ONLY TWO OF THE WELLS PRODUCING DURING 1996. A STRATEGIC DECISION TO SELL CERTAIN NORTHERN PROPERTIES HAVING LITTLE POTENTIAL FOR EARLY CASH FLOW HAS RESULTED IN LEXXOR RETAINING AN INTEREST IN ONLY TWO NORTHERN PROPERTIES (CONROY AND BULRUSH) WHILE GENERATING PROCEEDS OF $1.78 MILLION THROUGH THE SALE OF SHUT-IN RESERVES.

MID 1996 SAW THE COMPANY RE-ALLOCATE ITS EFFORTS TO THE SOUTHERN PLAINS PROJECT AREA RESULTING IN DISCOVERIES OF HEAVY OIL, LIGHT OIL AND NATURAL GAS IN FIVE DISTINCT PROSPECT AREAS IN SOUTH CENTRAL ALBERTA AND SASKATCHEWAN. THESE AREAS OFFER YEAR ROUND ACCESS, AN ESTABLISHED PRODUCTION INFRASTRUCTURE AND MULTIPLE GEOLOGICAL TARGETS AT SHALLOWER DEPTHS. A STRONG FOURTH QUARTER DRILLING PROGRAM (NINE WELLS CASED OF TEN WELLS DRILLED) ADDED 90 BOPD TO LEXXOR'S PRODUCTION BASE AND, AS IMPORTANTLY, HAS PROVIDED SEVERAL DEVELOPMENT DRILLING LOCATIONS ADJACENT TO LATE-1996 DISCOVERIES.



LAND HOLDINGS (as at December 31, 1996) (1) (2) (3)

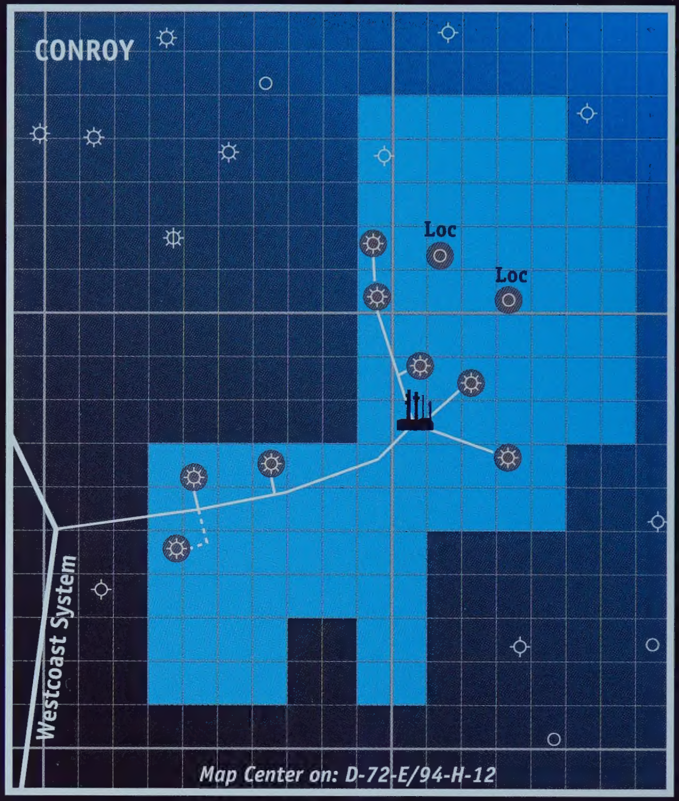
	Undeveloped Acreage		Developed Acreage		Total Acreage	
	Gross	Net	Gross	Net	Gross	Net
Northern Area						
Tommy	12,420	1,863	6,900	1,035	19,320	2,898
Martin	6,900	946	2,070	518	8,970	1,464
Bulrush	1,400	192	2,800	420	4,200	612
Other	7,856	1,521	690	173	8,546	1,694
Northern Total	28,576	4,522	12,460	2,146	41,036	6,668
Southern Area						
Misty/Court	9,156	5,634	760	316	9,916	5,950
Other	2,040	726	1,000	256	3,040	982
Southern Total	11,196	6,360	1,760	572	12,956	6,932
Total	**39,772**	**10,882**	**14,220**	**2,718**	**53,992**	**13,600**

1. *Subsequent to December 31, 1996 up to March 26, 1997 Lexxor has acquired an additional 4,520 gross acres (2,856 net acres) of undeveloped acreage all of which is in the Southern Plains Project Area.*
2. *In addition to Company owned lands, Lexxor has options to earn negotiated interests in 16,280 gross acres, primarily in the Southern Area.*
3. *Subsequent to December 31, 1996 Lexxor sold its interest in a shut-in gas property in northeast British Columbia including interests in 2,070 gross developed acres (518 net acres) and 6,210 gross undeveloped acres (860 net acres).*

NORTHERN GAS PROJECT

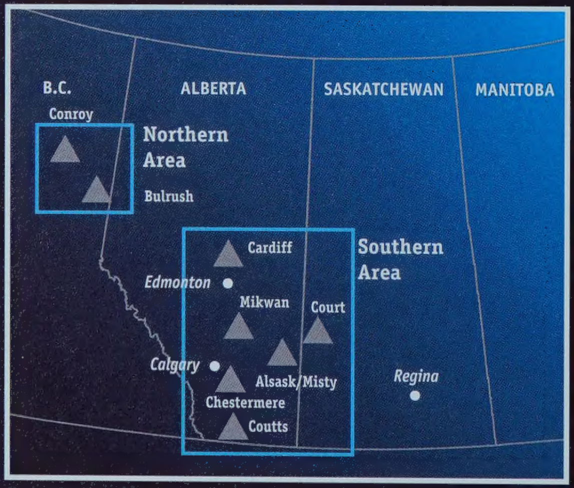
Conroy, British Columbia (Natural Gas)

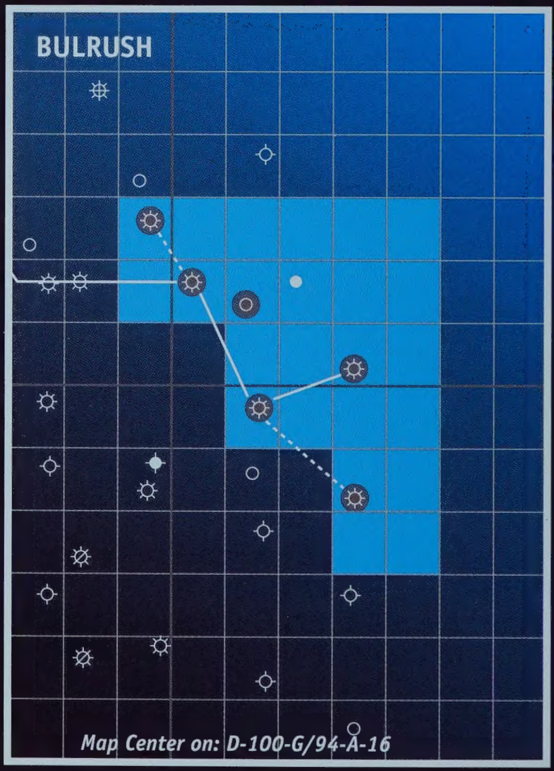
Lexxor retains a 15 percent interest in 28 sections of contiguous acreage in the gas prone Conroy area of north eastern British Columbia. Drilling successes (eight potential gas wells) in the winters of 1996 and 1997 have established the reserve threshold required to proceed with construction of a new gas facility having a capacity of ten million cubic feet per day. The $6 million project is nearing completion with Lexxor's share of production expected to reach 160 barrels of oil equivalent per day of natural gas and associated liquids from Bluesky and Gething Sand gas reservoirs. Several additional drilling locations have been delineated with an incrementally inexpensive doubling of plant capacity ($1.5 million gross) achievable through the addition of a parallel compressor.

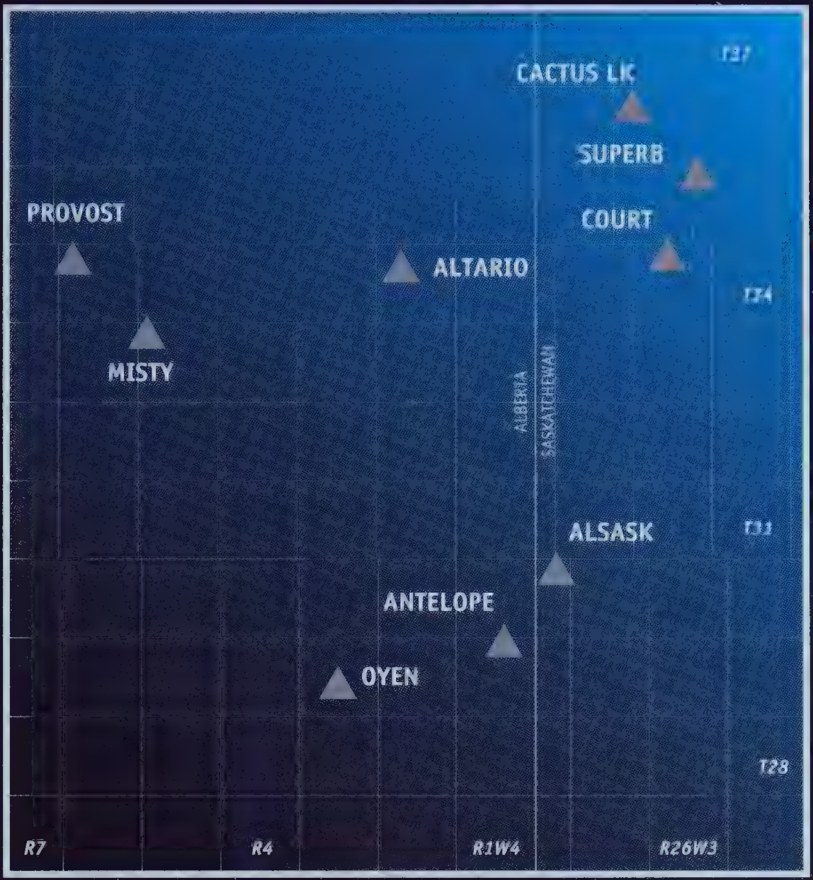


Bulrush, British Columbia (Natural Gas)

Drilling at Bulrush during 1996 and early 1997 has resulted in six potential gas wells, at a Lexxor working interest of 15 percent. Three of the wells are currently producing and an additional tie-in planned will increase gross production to approximately 5 Mmcf/d (750 mcf/d net). Additional locations are evident and drilling will be resumed next winter in this high reserve potential area (average 3 to 5 bcf per well).







SOUTHERN PLAINS PROJECT

Lexxor drilled its first Company operated well in June 1996 and discovered a new heavy oil pool in the Court/Plover Lake area of western Saskatchewan. As other Southern Area prospects reached the drilling stage, six new wells were drilled in the Southern Area, resulting in three oil wells, two gas wells and one dry hole. Of the up to 30 wells planned for 1997, 80 percent are slated for drilling in the Southern Plains project.

Court/Plover Lake (Heavy Oil)

A new pool discovery in the Bakken Sand marked Lexxor's entry into the heavy oil play in western Saskatchewan – an area characterized by significant production volumes and vast reserve potential for low gravity crude oil. Through the recent implementation of high volume rotary pump technology Lexxor has optimized production from its first well at rates of over 100 BOPD of 11.2° API crude oil. Plans for 1997 include full development of the pool through the drilling of up to seven new wells as defined by three dimensional seismic. Oil treating and water disposal facilities are also planned as the current trucking of produced water and payment of processing fees to third parties drives up operating costs and reduces netbacks.

Lexxor has acquired an average 50 percent interest in prospective acreage on exploratory plays at Luseland, Superb and Cactus Lake in the heavy oil corridor straddling the Alberta/Saskat-chewan border and plans to drill these prospects during 1997.

Coutts (Light Oil)

Fourth quarter drilling resulted in a light oil discovery (39^{0} API gravity) in this Southern prospect area. The well has been averaging a steady 60 BOPD since being placed on production in late December with Lexxor retaining a 35 percent interest in the well and follow-up locations as defined by three dimensional seismic. Two development locations are planned for second quarter 1997 drilling.

Misty/Oyen (Gas)

During the second half of 1996 Lexxor began building an acreage position in a multizone gas prospect area immediately west of the Alberta/Saskatchewan border. Farm-in negotiations and successful bids at Crown Land Sales have led to the acquisition of 18 sections of petroleum and natural gas rights and the drilling of a dual zone gas discovery at Misty (shut-in). Lexxor has an average 65 percent working interest in 12,000 acres of prospective acreage and has options to earn interests in an additional 4,480 gross acres. Six wells are planned in this area this summer.

SOUTHERN PLAINS OUTLOOK

An active program is planned in the Southern area in 1997. In addition to the activity outlined above, 1996 results have spawned the plans highlighted below:

Chestermere (Gas): Successful farm-in negotiations which include access to gas plant facilities will see a moderate risk/high reward Elkton test drilled just east of Calgary. Lexxor has a 40 percent interest in this gas and liquids prospect.

Mikwan (Oil): A follow-up development well will be drilled adjacent to a late 1996 Nisku Reef discovery which is capable of approximately 75 BOPD. Lexxor has a 26.25 percent interest in the discovery and 15.75 percent in the follow-up well.

Cardiff (Gas): Lexxor (50 percent) will drill a two well program targeting natural gas in the Ostracod Sand.

Garrington (Gas): Successful farm-in negotiations have led to a Lexxor commitment to pay 45 percent of an exploratory test in pursuit of high deliverability natural gas reserves west of Red Deer. The Company will earn an interest in four sections and will retain an option to drill a second well to earn additional acreage. The well is expected to be drilled in April.

Ingoldsby (Oil): Following the drilling of a successful horizontal oil well in southern Saskatchewan we are reviewing the merit of one possible follow-up across the producing Frobisher oil pool. Lexxor has a 25 percent interest in the successful well, which has been averaging 160 BOPD since being placed on production in late 1996.

DRILLING ACTIVITY

Lexxor participated at an average interest of 25% in the drilling of 31 wells during 1996, resulting in 21 potential gas wells, 4 oil wells and 6 dry holes for a success ratio of 76 percent.

	Exploratory		Development		Total	
	Gross (1)	Net(2)	Gross(1)	Net(2)	Gross(1)	Net(2)
Gas	14	3.03	7	1.35	21	4.38
Oil	2	0.85	2	0.55	4	1.40
Dry	2	0.50	4	1.35	6	1.85
Total	18	4.38	13	3.25	31	7.63
Average W.I.%	24.3		25.0		24.6	
Success %	89	89	69	58	81	76

(1) "Gross" wells means the number of wells in which Lexxor had a working interest.

(2) "Net" wells means the sum of the individual working interests in all gross wells in which Lexxor had a working interest.

OIL AND NATURAL GAS RESERVES

In a report effective December 31, 1996, Paddock Lindstrom & Associates Ltd. evaluated Lexxor's reserves of oil, natural gas liquids and natural gas. Proved plus risked probable oil and natural gas liquids reserves totaled 272 thousand barrels while natural gas reserves were 5.2 billion cubic feet. The Paddock Report assigned the following pre-tax present worth values to Lexxor's reserves ($ thousands):

	Discounted at		
	10%	15%	20%
Total Proved	$3,573	3,065	2,680
Risked Probable	416	321	254
Proved plus Risked Probable	3,989	3,386	2,934
ARTC	173	160	148
Total	$4,162	$3,546	$3,082

RECONCILIATION OF CHANGES IN RESERVES

The following tables provide the changes in gross reserves since December 31, 1995

Oil and Liquids

(MBbls)	Proved	Probable [2]	Total
December 31, 1995	3.3	0.8	4.1
Discoveries, 1996	254.7	60.3	315.0
Production	3.7	—	3.7
Dispositions	32.3	11.4	43.7
December 31, 1996	222.0	49.7	271.7

Natural Gas

(Mmcf)	Proved	Probable [2]	Total
December 31, 1995	120.2	30.3	150.5
Discoveries, 1996	6,112.4	1,420.8	7,533.2
Production	152.6	—	152.6
Dispositions	1,671.7	653.6	2,325.3
December 31, 1996	4,408.3	797.5	5,205.8

Barrels of Oil Equivalent

(MBOE) [1]	Proved	Probable [2]	Total
December 31, 1995	15.3	3.8	19.1
Discoveries, 1996	865.9	202.5	1,068.4
Production	18.9	-	18.9
Dispositions	199.5	76.8	276.3
December 31, 1996	662.8	129.5	792.3

(1) Thousand Barrels of Oil Equivalent (where 10 thousand cubic feet of natural gas = 1 barrel of liquids)

(2) Probable reserves gave been discounted by a factor of 50 percent to account for the risk associated with the probability of obtaining production from such reserves.

FINDING AND ON STREAM COSTS

While Lexxor's finding and on stream costs were unacceptably high in 1996, the Company's mid year move to the Southern Plains project area resulted in the addition of new higher working interest reserves at more favourable costs. Our 1997 program will see an increasing emphasis on Southern Area prospects. It should be noted that the schedule below includes "front end load costs" related to land acquisition and seismic programs for prospects which have not yet been drilled.

Finding and On Stream Costs Summary

($ except where noted)	**1996**
Finding costs	
Drilling and completions	5,141,738
Lease acquisitions and rentals	2,098,295
Seismic	603,226
Capitalized G & A	154,657
Total net finding costs	7,997,916
On stream costs	
Equipping costs tie-ins	730,804
Facilities	—
Total on stream costs	730,804
Finding plus on stream costs	8,728,720
Reserve discoveries (MBOE)	1,087.5
Costs per BOE ($)	
Finding costs	7.36
On stream costs	.67
Total and average per BOE	8.03

LEXXOR'S FINANCIAL STRATEGY WILL BE TO INCREASE SHAREHOLDER VALUE THROUGH:

EMPLOYMENT OF CASH FLOW AND, AT APPROPRIATE TIMES, EQUITY FOR HIGHER RISK EXPLORATION.

USE OF BANK DEBT FOR DEVELOPMENT DRILLING AND THE INFRASTRUCTURE REQUIRED TO BRING RESERVES ON STREAM, WITH DEBT LEVEL GENERALLY LIMITED TO 1.5 TIMES FORWARD YEAR CASH FLOW.

CONTROL OF COSTS AND EXPENDITURES WITH A FOCUS ON PROFITABILITY.

MODERATION OF COMMODITY PRICE RISK THROUGH A BALANCED MIX OF OIL AND LONGER LIFE NATURAL GAS RESERVES AND INTERMITTENT USE OF FORWARD SALES CONTRACTS.

ADDITION OF RESERVES AND PRODUCTION AT THE LOWEST POSSIBLE COST, WHETHER THROUGH EXPLORATION, DEVELOPMENT OR ACQUISITION.

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

The Company's activities during the period from date of incorporation, August 8, 1995 to December 31, 1995 and for the year ended December 31, 1996 have been directed towards the exploration for and development of petroleum and natural gas properties. These activities to date are considered by management to be in the preproduction stage. As a result, all costs associated with such activities, net of revenues, have been included as deferred exploration costs as a component of capital assets. Accordingly, there is no statement of earnings included in the financial statements. The ultimate recovery of the Company's investment is dependent upon the discovery of petroleum and natural gas reserves in commercial quantities. On January 1, 1997, the Company reached a level of commercial production and commenced to account for its exploration and development costs in accordance with the full cost method of accounting.

FOR THE YEAR ENDING DECEMBER 31, 1996

Financing

As at December 31, 1995, the Company had subscriptions receivable under the instalment option of its initial public offering of $2.7 million. These funds were received on March 1, 1996 and 546,900 Class B Shares were issued to subscribers.

On December 19, 1996, the Company closed a public offering of Class A flow-through shares for gross proceeds of $3,000,000. The Company issued 3,000 units each priced at $1,000 with each unit containing 840 Class A flow-through shares priced at $1.19 per share. A total of 2,520,000 new Class A shares were issued. The Company has an obligation to renounce, for income tax purposes $3,000,000 of Canadian Exploration Expense (CEE) and eligible Canadian Development Expense (CDE) with such renounced eligible CDE deemed to be CEE, to subscribers of the shares effective December 31, 1996.

Investing

Lexxor's philosophy is to fund exploration activity such as seismic and exploratory drilling through a combination of equity and cash flow while lower risk activities such as development drilling and the construction of facilities are funded through bank debt. Lexxor is primarily an exploration company. Our capital expenditures have been directed toward the exploration for, and development and production of oil and natural gas. Strategic acquisitions will be considered where Lexxor identifies a property which fits with existing operations.

Capital spending during the year ending December 31, 1996 totaled $8,291,399. These funds were expended on the drilling of 31 wells and the purchase of land, seismic and geological data in Alberta, British Columbia and Saskatchewan.

CAPITAL EXPENDITURES

	1996	Period Aug. 8/95 to Dec. 31/95
Petroleum and natural gas properties		
Land	$1,733,398	$ 385,358
Geological and seismic	673,434	33,663
Drilling	5,094,425	66,400
Well equipment and tie-ins	726,404	4,400
	8,227,661	489,821
Net production income	(132,953)	—
Interest income	(132,751)	(4,091)
Administrative Costs	273,116	7,916
Office furniture and equipment	56,326	965
	$8,291,399	$ 494,611

Under the terms of the initial public offering, the Company had an obligation to spend $7,092,280 on oil and gas exploration, development and land acquisition before March 1, 1997. This expenditure program commenced in December, 1995 and continued into 1996 with the drilling of wells and the acquisition of technical data and oil and gas rights in Alberta, Saskatchewan and British Columbia. At December 31, 1996, the Company had expended $6,850,727 on qualifying expenditures under the terms of this offering.

Under the terms of the public offering which closed in December 1996, the Company agreed to incur and renounce to subscribers effective December 31, 1996 a total of $3,000,000 in qualifying expenditures. Such qualifying expenditures are to consist of Canadian Exploration Expense (CEE) and eligible Canadian Development Expense (CDE) with such renounced eligible CDE deemed to be CEE to the subscriber.

The income tax deductions associated with these qualifying expenditures are renounced to investors and are therefore unavailable to the Company.

In September 1996, the Company sold certain interests in oil and gas properties to Blue Range Resource Corporation, the operator and a related party to the Company, for gross proceeds of $1,250,000. The sale price was determined with reference to independent evaluations of the properties.

Liquidity and Capital Resources

At December 31, 1996, the Company had working capital of $2,349,990 to be spent on further exploratory and development drilling. Subsequent to year end, the Company negotiated a revolving production loan facility in the amount of $750,000. This facility combined with working capital at December 31, 1996 and expected 1997 cash flow will be the primary sources of our 1997 capital expenditure program estimated to total $7,385,000.

At December 31, 1996, the Company had 7,003,600 Class A shares outstanding, 1,418,456 Class B shares outstanding and 1,541,800 warrants exerciseable into 1,541,800 Class A shares at $1.50 per share until June 30, 1997.

In January 1997, the Company increased its cash position by $500,000 through a private placement to Blue Range of 400,000 units. Each unit contained one Class A share of Lexxor at $1.25 and one half of a Class A share purchase warrant. Each warrant entitles Blue Range to acquire one Class A share of the Company at a price of $1.55 until July 25, 1998.

In addition, in March 1997 the Company generated $525,000 through the sale of certain interests in oil and gas properties to an arm's length third party.

Lexxor will satisfy its future short and long term capital needs using a combination of sale of Class A shares from treasury, use of our credit facility and funds generated from its exploration and development programs.

Management is confident that the Company's working capital, its credit facility and the cash flow resulting from its exploration and development work will be sufficient to meet ongoing obligations.

FOR THE PERIOD AUGUST 8, 1995 TO DECEMBER 31, 1995

Financing Activities

Lexxor was incorporated on August 8, 1995, and subsequently issued 1,400,000 Class A shares to the founders of the Company at a price of $0.20 per share for total proceeds of $280,000. On December 29, 1995, the Company closed its initial public offering raising a total of $7,709,000. The equity issue was sold in units of $1,000 with each unit consisting of 400 Class A shares, 184 Class B (flow-through) shares and 200 Class A share purchase warrants. A total of 3,083,600 Class A shares and 871,556 Class B shares were issued for cash at $0.20 and $5.00 per share, respectively. At December 31, 1995, there were 4,483,600 Class A shares, 871,556 Class B shares and 1,541,800 Warrants issued and outstanding. The public offering provided for an instalment option, except to Ontario subscribers, whereby the subscription price was payable as to half at closing and half by cheque post-dated to March 1, 1996. As a result of some subscribers choosing the instalment option, an additional 546,900 Class B shares were reserved for issuance pursuant to the instalment option. On March 1, 1996, upon receipt of $2,734,500 cash consideration, 546,900 Class B shares were

issued. The 1,418,456 Class B shares outstanding as March 1, 1996 are convertible, at the option of the Company, into Class A shares at any time after November 30, 1998 and before November 30, 2000. The number of Class A shares to be issued upon conversion of each Class B share will be equal to $5.00 divided by the greater of $1.00 and the then current market price of the Class A shares. The conversion will result in a maximum of 7,092,280 Class A shares being issued.

Each warrant entitles the holder to acquire one Class A share for $1.50 until June 30, 1997.

Investing

Capital expenditures for the period August 8, 1995 to December 31, 1995 totaled $494,611. The expenditures were incurred in the drilling of two working interest wells in central Alberta and on the purchase of oil and gas rights in British Columbia.

As part of the initial public offering, Lexxor agreed to incur and renounce to the subscribers of the Class B (flow-through) shares a total of $7,092,280 in qualifying expenditures. Such qualifying expenditures were to consist of Canadian Exploration Expense (CEE), eligible Canadian Development Expense (CDE), with such renounced eligible CDE deemed to be CEE to the subscriber, and Canadian Oil and Gas Property Expense (COGPE). As at December 31, 1995 $399,021 had been spent on qualifying expenditures. The income tax deductions associated with these qualifying expenditures are renounced to investors and are therefore unavailable to the Company

Liquidity and Capital Resources

At December 31, 1995, Lexxor had cash and funds held in trust related to the initial public offering of $4,513,961. In addition, the Company had subscriptions receivable under the instalment option for an additional $2,734,500. These funds were received on March 1, 1996 and 546,900 Class B shares were issued to subscribers. At December 31, 1995, the Company had working capital of $3,989,521.

BUSINESS RISKS

Lexxor is an oil and gas exploration and production company whose core business is the exploration for, and development and production of crude oil and natural gas, primarily in north eastern British Columbia, east central Alberta and western Saskatchewan. Activity within the energy industry has inherent risks which we strive to mitigate.

Exploration and Development Risk

Lexxor seeks to reduce exploration, development and production risks through the employment of highly qualified staff and focusing on project areas where our professionals have a strong background. We drill a large number of low cost wells, thereby ensuring that an unsuccessful well does not have an undue negative impact on overall Company performance. Where the Company participates in deeper, more expensive wells we retain lower working interests to mitigate financial risks.

Marketing and Pricing Risk

Crude oil and natural gas prices are dictated by supply and demand fundamentals beyond Lexxor's control. We reduce price risk through an emphasis on profitability, which entails a focus on operating costs and finding and on-stream costs. Lexxor's focus is on core areas having multizone potential for both oil and natural gas and is seeking an approximate 50/50 balance between these commodities.

Financial and Liquidity Risks

Lexxor relies on three funding sources for its capital spending programs. Cash flow projections and bank debt define a baseline expenditure level. To the extent that new equity can be accessed on favourable terms, our budget may be increased during the course of the year. Our conservative approach to the use of debt dictates that it be limited to a maximum of 1.5 times forward year cash flow. We have not entered into commodity or financial hedging arrangements, but will consider these techniques in a spectrum of risk reduction alternatives.

Environmental Risks

Lexxor acknowledges the potential risks to the environment related to its core business activities, including potential pollution of water bodies, land and the atmosphere. Lexxor's Board of Directors has, on behalf of all shareholders, committed the Company to protect and maintain the environment through the structuring of a formal environmental policy. Implementation of policy initiatives is the responsibility of senior management who disseminate expectations throughout our operations. Lexxor's field facilities are essentially new and have been constructed and are operated in compliance with all provincial and federal regulations. Lexxor intends to undertake a base-case environmental audit of all Company operated properties in 1997 and will conduct an all property assessment at least every three years to provide an environmental report card for the Company.

BUSINESS PROSPECTS

Lexxor's portfolio of promising oil and gas prospects provides optimism that the Company will establish a strong pattern of growth through 1997 and beyond. Our inventory of exploration ideas is only limited by access to capital.

In 1997 Lexxor will spend approximately 67 percent of its capital expenditure budget on natural gas exploration, development and related surface facilities. Oil opportunities will remain an important part of the growth program as light to heavy gravity prospects are pursued in the belief that oil prices will remain firm and provide good economic returns. Lexxor's fundamental strategies for enhancing shareholder value are firmly in place.

TRADING RANGE OF CLASS A COMMON SHARES

1996	High	Low	Close	Volume
First Quarter	$2.10	$1.55	$1.60	512,700
Second Quarter	1.65	1.00	1.30	124,100
Third Quarter	1.45	1.05	1.10	109,100
Fourth Quarter	1.35	.95	1.20	193,121
Year Ending December 31, 1996	2.10	.95	1.20	939,021

The Class A Shares commenced trading on The Alberta Stock Exchange on January 29, 1996.

Net Asset Value per Share

($ thousands except per share)	1996
Reserves, risked and discounted at 15% before tax	3,546.1
Undeveloped land	1,450.0
Seismic data	300.0
Working capital (deficit)	2,350.0
Net asset value	7,646.1
Shares outstanding at December 31 (thousands) (1)	
Basic	7,003.6
Fully Diluted	12,913.8
Net asset value per share (4)	
Basic	1.09
Fully diluted	0.59

(1) Fully diluted shares outstanding at December 31, 1996 include Common Shares outstanding plus the assumed conversion into Class A shares of the 1,418,456 Class B shares at $5.00 divided by the year end market price of $1.20 of the Class A shares (the Class B shares are convertible at the Company's option at any time after November 30, 1998 and before November 30, 2000 and automatically by January 31, 2001 at $5.00 divided by the greater of $1.00 and the then current market value of the Class A shares).

MANAGEMENT'S REPORT

THE FINANCIAL STATEMENTS OF LEXXOR ENERGY INC. WERE PREPARED BY MANAGEMENT IN ACCORDANCE WITH ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN CANADA. THE FINANCIAL AND OPERATING INFORMATION PRESENTED IN THIS ANNUAL REPORT IS CONSISTENT WITH THAT SHOWN IN THE FINANCIAL STATEMENTS.

MANAGEMENT HAS DESIGNED AND MAINTAINS A SYSTEM OF INTERNAL CONTROLS TO PROVIDE REASONABLE ASSURANCE THAT ALL ASSETS ARE SAFEGUARDED AND TO FACILITATE THE PREPARATION OF RELIABLE AND TIMELY FINANCIAL STATEMENTS FOR REPORTING PURPOSES. TIMELY DISCLOSURE REQUIRES THE USE OF ESTIMATES WHEN TRANSACTIONS AFFECTING THE CURRENT ACCOUNTING PERIOD CANNOT BE FINALIZED OR KNOWN FOR CERTAIN UNTIL FUTURE PERIODS. SUCH ESTIMATES ARE BASED ON JUDGMENTS MADE BY MANAGEMENT USING ALL RELEVANT INFORMATION KNOWN AT THE TIME.

EXTERNAL AUDITORS APPOINTED BY THE SHAREHOLDERS HAVE EXAMINED THE CORPORATE AND ACCOUNTING RECORDS IN ORDER TO EXPRESS THEIR OPINION ON THE FINANCIAL STATEMENTS. THE AUDIT COMMITTEE HAS MET WITH THE EXTERNAL AUDITORS AND MANAGEMENT IN ORDER TO DETERMINE IF MANAGEMENT HAS FULFILLED ITS RESPONSIBILITIES IN THE PREPARATION OF THE FINANCIAL STATEMENTS. THE AUDIT COMMITTEE HAS REPORTED ITS FINDINGS TO THE BOARD OF DIRECTORS WHO HAVE APPROVED THE FINANCIAL STATEMENTS.

RONALD R. TALBOT
PRESIDENT AND CHIEF EXECUTIVE OFFICER

J. PAUL LAWRENCE
VICE PRESIDENT, FINANCE AND CHIEF FINANCIAL OFFICER

AUDITORS' REPORT TO THE SHAREHOLDERS

WE HAVE AUDITED THE BALANCE SHEETS OF LEXXOR ENERGY INC. AS AT DECEMBER 31, 1996 AND 1995 AND THE STATEMENTS OF CHANGES IN FINANCIAL POSITION FOR THE YEAR ENDED DECEMBER 31, 1996 AND FOR THE PERIOD FROM AUGUST 8, 1995 TO DECEMBER 31, 1995. THESE FINANCIAL STATEMENTS ARE THE RESPONSIBILITY OF THE COMPANY'S MANAGEMENT. OUR RESPONSIBILITY IS TO EXPRESS AN OPINION ON THESE FINANCIAL STATEMENTS BASED ON OUR AUDITS.

WE CONDUCTED OUR AUDITS IN ACCORDANCE WITH GENERALLY ACCEPTED AUDITING STANDARDS. THOSE STANDARDS REQUIRE THAT WE PLAN AND PERFORM AN AUDIT TO OBTAIN REASONABLE ASSURANCE WHETHER THE FINANCIAL STATEMENTS ARE FREE OF MATERIAL MISSTATEMENT. AN AUDIT INCLUDES EXAMINING, ON A TEST BASIS, EVIDENCE SUPPORTING THE AMOUNTS AND DISCLOSURES IN THE FINANCIAL STATEMENTS. AN AUDIT ALSO INCLUDES ASSESSING THE ACCOUNTING PRINCIPLES USED AND SIGNIFICANT ESTIMATES MADE BY MANAGEMENT, AS WELL AS EVALUATING THE OVERALL FINANCIAL STATEMENT PRESENTATION.

IN OUR OPINION, THESE FINANCIAL STATEMENTS PRESENT FAIRLY, IN ALL MATERIAL RESPECTS, THE FINANCIAL POSITION OF THE COMPANY AS AT DECEMBER 31, 1996 AND 1995 AND THE CHANGES IN ITS FINANCIAL POSITION FOR THE YEAR ENDED DECEMBER 31, 1996 AND FOR THE PERIOD FROM AUGUST 8, 1995 TO DECEMBER 31, 1995 IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES.

Coopers & Lybrand

CHARTERED ACCOUNTANTS
CALGARY, ALBERTA
MARCH 4, 1997

BALANCE SHEETS

As at December 31 1996 and 1995

$	1996	1995
ASSETS		
Current assets		
Cash and short-term investments	2,792,453	2,705,119
Accounts receivable (notes 2 and 5)	717,312	1,808,842
Prepaid expenses	15,614	
	3,525,379	4,513,961
Capital assets (note 3)	4,511,010	319,611
	8,036,389	4,833,572
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities (note 5)	1,175,389	524,440
SHAREHOLDERS' EQUITY		
Share capital (note 4)	6,861,000	4,309,132
	8,036,389	4,833,572

Signed on Behalf of the Board

STATEMENTS OF CHANGES IN FINANCIAL POSITION

For the year ended December 31, 1996 and for the period from August 8, 1995 to December 31, 1995

$	1996	1995
Financing activities		
Issue of common shares (note 4)	5,734,500	5,254,500
Share issue costs	(332,632)	(770,368)
Change in non-cash working capital	1,314,452	(1,686,671)
	6,716,320	2,797,461
Investing activities		
Capital assets	(8,291,399)	(494,611)
Sale of properties	1,250,000	
Change in non-cash working capital	412,413	402,269
	(6,628,986)	(92,342)
Increase in cash and short-term investments	87,334	2,705,119
Cash and short-term investments - Beginning of period	2,705,119	
Cash and short-term investments - End of period	2,792,453	2,705,119

For the year ended December 31, 1996 and for the period from August 8, 1995 to December 31, 1995

Lexxor Energy Inc. (the "Company") was incorporated under the laws of Alberta on August 8, 1995 as 663900 Alberta Inc. On September 27, 1995, the Company filed a Certificate of Amendment changing its name to Lexxor Energy Inc. The Company's shares began trading on The Alberta Stock Exchange on January 29, 1996.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been presented by management in accordance with accounting principles generally accepted in Canada and include the following accounting policies.

Basis of presentation

The Company's activities during the period from date of incorporation, August 8, 1995, to December 31, 1995 and for the year ended December 31, 1996, have been directed towards the exploration for and development of petroleum and natural gas properties. These activities to date are considered by management to be in the preproduction stage. As a result, all costs associated with such activities, net of revenues, have been included as deferred exploration costs as a component of capital assets (note 3). Accordingly, there is no statement of earnings included with these financial statements. The ultimate recovery of the Company's investment is dependent upon the discovery of petroleum and natural gas reserves in commercial quantities. When the Company reaches a level of commercial production, all deferred costs will be transferred to the Company's full cost pool.

Petroleum and natural gas properties

Once commercial production is achieved, the Company will follow the full cost method of accounting for petroleum and natural gas operations whereby all costs related to the exploration for and development of petroleum and natural gas properties and related reserves are capitalized. Such costs will include land acquisition costs, geological and geophysical expenditures, costs of drilling both productive and non-productive wells, tangible production equipment and that portion of general and administrative expenditures directly related to exploration and development activities.

Capitalized costs, including tangible production equipment will be depleted using the unit-of-production method based on estimated proven reserves of petroleum and natural gas before royalties as determined by management and reviewed by an independent reserve engineer.

Gains or losses on the sale or disposition of petroleum and natural gas properties are not ordinarily recognized except under circumstances which result in a significant change in the depletion rate.

The Company will annually apply a "ceiling test" to capitalized costs to ensure that such costs do not exceed the cost of future net revenues from estimated production of proven reserves, using prices and costs in effect at year-end, less amounts associated with future general and administrative costs, financing costs, site restoration costs and income tax expense.

Joint Ventures

Substantially all of the Company's exploration and development activities are conducted jointly with other industry participants, and accordingly the financial statements reflect only the Company's proportionate interest in such activities.

Flow-through shares

The Company's December 1996 public offering and, in part, its initial public offering included the issue of flow-through shares. Under this financing arrangement shares are issued at a fixed price and the resultant proceeds are used to fund property acquisition and exploration and development work within a defined time period. The income tax deductions associated with the expenditures funded by flow-through arrangements are renounced to investors in accordance with the appropriate tax legislation. Petroleum and natural gas properties and share capital are reduced by the estimated cost of the renounced tax deductions when the expenditures are incurred.

Future site restoration and abandonment costs

Once full commercial production is achieved, the Company will evaluate costs related to future site restoration and well abandonment. These estimated costs will be provided for on the unit-of-production method and will be included in depletion and depreciation expense.

2 ACCOUNTS RECEIVABLE

The accounts receivable balance at December 31, 1996 includes an amount of $464,000 (1995 - $1,803,855) which relates to monies held by Montreal Trust in connection with the issuance of shares. The amount outstanding at December 31, 1996 was received by the Company in January 1997.

3 CAPITAL ASSETS

$	**1996**	1995
Deferred exploration costs		
Petroleum and natural gas properties	**3,901,677**	310,421
Well equipment	**540,805**	4,400
Net production income	**(132,953)**	—
Interest income	**(136,842)**	(4,091)
Administrative costs	**281,032**	7,916
	4,453,719	318,646
Office furniture and equipment	**57,291**	965
	4,511,010	319,611

Petroleum and natural gas properties are presented net of $3,025,000 (1995 - $175,000) of income tax benefits renounced to the Company's shareholders (note 4(e)).

4 SHARE CAPITAL

a) Authorized

Unlimited number of Class A voting shares

Unlimited number of Class B voting shares, convertible at the option of the Company at any time after November 30, 1998 and before November 30, 2000 into Class A shares upon 5 days prior notice to holders of Class B shares. The fraction of a Class A share obtained upon conversion of each Class B share will be equal to $5.00 divided by the greater of $1.00 and the then current market price of the Class A shares. If the Company fails to exercise the conversion option by November 30, 2000, then the Class B shares shall be convertible, at the option of the shareholders, at any time after December 1, 2000 and before January 31, 2001 into Class A shares. Any Class B shares which have not been converted into Class A shares by January 31, 2001 will be deemed converted into Class A shares effective January 31, 2001.

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President and Chairman of the Board

J. Paul Lawrence (1)
Vice President, Finance

J. Gordon Ironside (1) (2)
President, Blue Range Resource Corporation

Michael P. Stanton (2)
Director, Blue Range Resource Corporation

Ronald J. Will (1) (2)
Vice President, Wolverton Securities Ltd.

(1) Member of the Audit Committee
(2) Member of the Compensation Committee

OFFICERS AND SENIOR PERSONNEL

Ronald R. Talbot
President and Chief Executive Officer

J. Paul Lawrence
Vice President, Finance
and Chief Financial Officer

Wayne E. Merkel
Manager, Exploration

Patricia J. Allen
Officer Manager

Gregory G. Turnbull
Corporate Secretary

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2000, 801 - Sixth Avenue S.W.
Calgary, Alberta T2P 3W2

REGISTRAR AND TRANSFER AGENT

Montreal Trust Company of Canada
Calgary and Toronto

EXCHANGE LISTING

The Alberta Stock Exchange

STOCK SYMBOLS

Class A Shares: LXX.A
Class B Shares: LXX.B
Warrants: LXX.WT.A

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